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Environmental Liability Pitfalls for Public Employee Retirement Systems

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ENVIRONMENTAL LIABILITY PITFALLS FOR PUBLIC EMPLOYEE RETIREMENT SYSTEMS

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On February 2, 1990, the Operating Engineers Local 37 Pension Fund filed suit against several former owners of a 64-acre site in Reistertown, Maryland, that the fund had purchased several years earlier. The lawsuit was filed after pension fund officials discovered that the land, on which the fund had intended to develop a shopping center and 426 residential units, was contaminated with high concentrations of allegedly carcinogenic heavy metals and volatile organic compounds. The suit alleged negligence, fraud and nuisance, among other counts, and sought $5 million in compensatory damages and $25 million in punitive damages from each defendant on each count. In its current state, the land is, at best, worthless; at worst, the hazardous waste contamination could turn the pension fund's asset into a multi-million dollar liability for hazardous waste clean-up costs.

INTRODUCTION

PENSION plan fiduciaries and their counsel are becoming increasingly concerned by a statute that intuitively may seem unrelated to pension plans, but, in actuality, could have profound significance for them. That statute is the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or Superfund).[1] Pension plans are not in the business of manufacturing, handling, using or disposing of hazardous chemicals. Nonetheless, pension plan administrators must be wary of and take precautions against CERCLA liability, else risk potential losses unparalleled in their routine operations.

Pension plans may be subject to CERCLA liability through two of their activities: (1) direct investment in real estate[2] or (2) loans secured

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1. CERCLA §§ 101-308 (1980), 42 U.S.C. §§ 9601-9675 (1983 & Supp. 1988). Public employee retirement systems investing in, or making loans secured by, real property also face other environmental risks, including, among others, liability under the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. § 6901, 6981 (1976) (the hazardous waste regulatory law), or liability for indoor air pollution. *See* Kirsch, Legal Developments in Indoor Air Pollution, *Indoor Air Pollution: A Complete Resource Guide* (BNA 1988); Kirsch, *Behind Closed Doors: Indoor Air Pollution and Government Policy*, 6 HARV. ENVTL. L. REV. 339 (1982). This article, however, will focus on liability under CERCLA.

2. Plans may invest directly in real estate by buying it or entering into sale and lease-

by real property or manufacturing operations.[3] Moreover, plans may find their once-valuable investments and their collateral for loans to be worthless when CERCLA liabilities arise. Therefore, plan administrators are well advised to educate themselves about CERCLA and the means of protecting their plans against the statute's broad reach.

Given the magnitude of CERCLA liability, any prudent business person investing in or making loans secured by real estate has reason for concern. Plan fiduciaries, however, must be especially wary. They are charged with duties of loyalty, prudence, portfolio diversity, and compliance with the plan's instruments. While the possibility of high returns on investments led plans away from traditional portfolios of United States government securities, highly-rated debt instruments, and common stock of blue chip companies and into more lucrative investments in real estate, the duty of prudence to protect fund assets obligates administrators to exercise particular caution in certain real estate investments.

This article will discuss the susceptibility of public employee pension funds to liability under CERCLA. First, the article will present an overview of CERCLA. This overview includes a discussion of CERCLA's enactment and amendment, an analysis of its statutory structure, parties held liable under CERCLA, substances considered hazardous under CERCLA, the Superfund clean-up process, and the statutory standard of liability. Second, the article will review the effect of CERCLA liability upon pension funds. Finally, the article will present certain suggestions that pension plan fiduciaries and lawyers may wish to consider in minimizing the risks of incurring environmental liability under CERCLA without foregoing the benefits of investing in real estate.

I. OVERVIEW OF CERCLA

A. *CERCLA's Enactment and Amendment*

Spurred by the public outcry and alarm generated by the discovery of such troubled sites as Love Canal and Times Beach, Congress enacted CERCLA in 1980 to address the problem of inactive and abandoned hazardous waste sites throughout the country. In Congress' haste to respond to this growing problem, staffers hurriedly pieced together largely inconsistent Senate and House bills,[4] and in just two days drafted the bill

back arrangements. In addition, plans may invest in real estate through pooled arrangements such as partnerships, joint ventures, real estate investment trusts, or bank-sponsored common trust funds. Moreover, a plan may invest passively in real estate by acquiring mortgage-backed securities guaranteed by the Federal Home Loan Mortgage Corporation or the Government National Mortgage Association. *See generally* Kanner, *Pension Fund Investment in Real Estate*, 8 REAL EST. L.J. 343 (1980); [1982] Pens. Rep. (BNA) No. 376, at 74 (1982).

3. Plans may finance real estate investments by providing construction financing for a project or by providing mortgage financing for acquisition of the property.

4. S. 1480, 96th Cong., 2d Sess., 126 CONG. REC. 30,898 (1980); H.R. 7020, 96th Cong., 2d Sess., 126 CONG. REC. 26,689 (1980); H.R. 85, 96th Cong., 2d Sess., 126 CONG. REC. 26,334 (1980).

that became CERCLA.[5] Too often, Congress resolved disagreements in approach or philosophy by omitting disputed provisions from the legislation. For example, as enacted in 1980, CERCLA held certain enumerated classes of parties liable for the cost of remedying sites at which hazardous substances had been disposed,[6] but the statute did not specify whether the liability it created was strict, joint or several. CERCLA also failed to clarify the role of causation in determining the scope of a party's liability. The burden of bringing order from the chaos fell to the United States Environmental Protection Agency (EPA), the agency charged with administering CERCLA, and the courts.

Congress amended CERCLA by passing the Superfund Amendments and Reauthorization Act of 1986 (SARA).[7] SARA was hailed as a reform statute, designed to bridge the gaps created by CERCLA. Any cures which SARA may have provided, however, are difficult to ascertain. For example, although SARA purported to resolve several of the disputed issues of interpretation that had arisen since CERCLA's enactment, the courts, in fact, had already resolved many of those issues before SARA was passed.[8] What SARA did achieve, however, was the creation of a series of elaborate, burdensome, and costly standards and procedures that must be followed in all Superfund clean-up actions. Unfortunately, the implementation of those standards and procedures has served to increase the already prohibitive cost of Superfund remedial actions,[9] and to delay further the snail's pace at which those actions have been conducted.[10]

B. *Statutory Structure*

CERCLA authorizes EPA to respond to releases or threats of releases of hazardous substances. This response may take two forms. EPA may conduct short-term "removal actions," involving, for example, the removal of drums or soil, securing of the site, or building dikes to prevent contaminants from escaping from the site.[11] In addition, EPA may per-

5. *See* United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 578 (D. Md. 1986) ("The structure of section 107(a) [42 U.S.C. § 9607(a)], like so much of this hastily patched together Compromise Act, is not a model of statutory clarity.").

6. CERCLA § 107(a), 42 U.S.C. § 9607(a) (1988).

7. Pub. L. No. 99-499, §§ 1-405, 100 Stat. 1613-1781 (1986).

8. For example, before SARA was enacted, several courts had decided that liability under CERCLA must be joint and several. *See* United States v. Northeastern Pharm. and Chem. Co., 579 F. Supp. 823 (W.D. Mo. 1984); United States v. Wade, 577 F. Supp. 1326 (E.D. Pa. 1983); United States v. Chem-Dyne Corp., 572 F. Supp. 802 (S.D. Ohio 1983).

9. According to EPA, the average cost of remedying a Superfund site is $32 million. *See* 55 Fed. Reg. 6153, 6163 (1990) (to be codified at 40 C.F.R. § 300).

10. As of February 28, 1990, only 46 of the approximately 1,000 sites placed on EPA's National Priorities List (a prioritized list of hazardous waste sites qualifying for federal Superfund attention) have been remediated. *See Superfund Progress Report*, Office of Solid Waste and Emergency Response, United States Environmental Protection Agency (April 6, 1990). *See infra* note 57 and accompanying text.

11. CERCLA § 101(23), 42 U.S.C. § 9601(23) (1988).

form longer-term and more expensive types of clean-up actions known as "remedial actions."[12] Remedial actions might entail, for example, the installation of an underground slurry wall to cut off groundwater flow to or from the contaminated area, the pumping and treatment of groundwater, and the placement of a clay cap over a site both to eliminate contact with the contaminated surface and to prevent rainwater from washing contaminants into the groundwater.

CERCLA created an $8.5-billion fund that the government may use to finance clean-up activities.[13] Congress, however, did not intend for CERCLA to become a public-works bill under which the federal or state governments would shoulder the cost for most hazardous waste clean-ups.[14] To avoid that result, CERCLA enumerates classes of individuals who are liable for such cost.[15] Such persons are commonly known as "potentially responsible parties" or "PRPs." Under CERCLA, EPA either may issue administrative orders directing PRPs to clean up sites (under section 106) or may perform the response actions itself and recover its costs of clean-up from the PRPs (under section 107). Much of the authority afforded to EPA has been delegated to state governments.[16] CERCLA further authorizes private parties (whether or not they are PRPs) to recover remedial costs from PRPs.

C. *Parties Held Liable Under CERCLA*

CERCLA imposes liability on four categories of persons[17] for costs connected with the clean-up of hazardous substances. Included in those categories is any person who:

> (1) currently owns or operates a facility at which hazardous substances have been disposed (even if such person did not dispose of the hazardous substances, was not aware of past disposal, and did not own the property at the time of disposal[18]);
> (2) formerly owned or operated a facility at the time of disposal of any hazardous substance;

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12. CERCLA § 101(24), 42 U.S.C. § 9601(24) (1988).

13. CERCLA § 111(a), 42 U.S.C. § 9611(a) (1988).

14. S. REP. NO. 848, 96th Cong., 2d Sess. 2, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 6119.

15. In addition to the potential for liability, CERCLA also authorizes the imposition of a lien on real property for the recovery of fund-financed costs. *See* 42 U.S.C. § 9607(1) (1988). The lien created by CERCLA is not a "superlien," *i.e.*, it does not have priority over the security interests of other creditors who have perfected their interests prior in time. Moreover, the federal lien is available only to EPA.

16. CERCLA §§ 104-106, 42 U.S.C. §§ 9604-9606 (1988).

17. As a result of recent amendments to SARA, there is some question as to whether there is also a fifth category of liable persons: an intervening landowner who sells his land without disclosing knowledge he has about contamination at the site. This possible fifth category, which could have a profound impact on pension fund liability, is discussed *infra* note 55 and accompanying text.

18. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1043-44 (2d Cir. 1985) (current property owner liable regardless of blamelessness).

(3) arranged for disposal or treatment (or for transportation for disposal or treatment) of any hazardous substance at a facility; or
(4) transported a hazardous substance to a facility selected by such person.[19]

The third entity described above, which has come to be known as a "generator" of hazardous substances, has dominated CERCLA litigation. The courts have found a surprising array of parties liable as "generators," including companies that sold hazardous material for profit,[20] entities that brokered waste deliveries,[21] organizations that had their pesticides processed by a third party,[22] and companies that arranged for material to be disposed of at a site different from the one at which the material actually was disposed.[23]

Recently, however, increased attention has focused upon the liability of owners or operators. The statute defines "owner or operator" simply as either a person owning or operating a facility, or, if the facility has been abandoned, a "person who owned, operated, or otherwise con-

19. CERCLA § 107(a), 42 U.S.C. § 9607(a) (1988). The actual language of section 107(a) is as follows:

Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section —
(1) the owner and operator of a . . . facility,
(2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,
(3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility . . . owned or operated by another party or entity and containing such hazardous substances, and
(4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities . . . or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for —
(A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;
(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;
(C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and
(D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title.

20. *See, e.g.*, United States v. Aceto Agric. Chem. Corp., 872 F.2d 1373, 1381-82 (8th Cir. 1989).

21. *See, e.g.*, O'Neill v. Piccillo, 682 F. Supp. 706, 728 (D.R.I. 1988), *aff'd*, 883 F.2d 176 (1st Cir. 1989), *cert. denied sub nom.*, 110 S. Ct. 1115 (1990); United States v. Conservation Chem. Co., 619 F. Supp. 162, 176, 240-41 (W.D. Mo. 1985); Missouri v. Independent Petrochem. Corp., 610 F. Supp. 4, 5 (E.D. Mo. 1985).

22. *See, e.g.*, Conservation Chem. Co., 619 F. Supp. at 176, 234; New York v. General Elec. Co., 592 F. Supp. 291, 297 (N.D.N.Y. 1984); United States v. A & F Materials Co., 582 F. Supp. 842, 844-45 (S.D. Ill. 1984).

23. *See, e.g.*, United States v. Bliss, 667 F. Supp. 1298, 1310 (E.D. Mo. 1987); United States v. Bliss, 16 Chem. Waste Lit. Rep. 1061 (E.D. Mo. 1988).

trolled activities at such facility immediately prior to such abandonment."[24] This statutory definition of "owner or operator," however, has been broadly interpreted by EPA and the courts. For example, a person may be liable as an "owner" even if he held title for only one hour.[25] Moreover, the courts have ruled that lessees of property fall within the statutory definition of "owner."[26] Additionally, officers and employees of companies operating a facility may be treated as owners or operators and, in some cases, may be held personally liable when they were performing the work of their employer.[27]

The definition of "facility" also is very broad, covering any location "where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located."[28] Clearly, the term is not limited to "dump sites." Indeed, CERCLA liability has been extended to such "facilities" as roads or dragstrips on which hazardous substances were spread,[29] residential developments,[30] and even individual homes to which hazardous substances had been transported on the clothing of factory workers.[31]

D. *Hazardous Substances Under CERCLA*

The broad liability provisions of CERCLA are exacerbated by the correspondingly broad definition of the statutory term "hazardous substance." When Congress drafted CERCLA in 1980, it took a shortcut in determining what substances should be considered hazardous. Rather than redefining those substances that warranted concern, Congress simply mandated that substances considered hazardous or toxic under a group of other environmental statutes[32] would comprise the universe of

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24. CERCLA § 101(20)(A)(iii), 42 U.S.C. § 9601(20)(A)(iii) (1988).

25. United States v. Carolawn, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20,698 (D.S.C. 1984).

26. *See, e.g.*, United States v. South Carolina Recycling & Disposal, Inc., 653 F. Supp. 984, 1003 (D.S.C. 1984).

27. *See, e.g.*, New York v. Shore Realty Corp., 759 F.2d 1032, 1052-53 (2d Cir. 1985); Kelly v. Arco Indus., Inc., 17 Chem. Waste Lit. Rep. 1114, 1117-18 (W.D. Mich. 1989); Vermont v. Staco, Inc., 684 F. Supp. 822, 831-32 (D. Vt. 1988); *Bliss*, 667 F. Supp. at 1306; United States v. Mottolo, 695 F. Supp. 615, 624 (D.N.H. 1988); United States v. Medley, 25 Env't Rep. Cas. (BNA) 1314, 1317-18 (D.S.C. 1986); United States v. Conservation Chem. Co., 628 F. Supp. 391, 416-20 (W.D. Mo. 1985).

28. CERCLA § 101(9)(B), 42 U.S.C. § 9601(9)(B) (1988); *see* United States v. Conservation Chem Co., 619 F. Supp. 162, 185 (W.D. Mo. 1985); *see also* United States v. Bliss, 667 F. Supp. 1298, 1305 (E.D. Mo. 1987) (horse stables and road where contaminated oil was sprayed).

29. *See, e.g.*, *Bliss*, 667 F. Supp. at 1303, 1305; United States v. Ward, 618 F. Supp. 884, 895 (E.D.N.C. 1985); New York v. General Elec. Co., 592 F. Supp. 291, 296 (N.D.N.Y. 1984) (dragstrip on which PCB-laden oil was placed).

30. *See* Tanglewood East Homeowners, Inc. v. Charles-Thomas, Inc., 849 F.2d 1568, 1572-73 (5th Cir. 1988).

31. *See* Vermont v. Staco, Inc., 684 F. Supp. 822, 833 (D. Vt. 1988).

32. *See* Clean Air Act, 42 U.S.C. §§ 7401-7642 (1988); Clean Water Act, 33 U.S.C. §§ 1251-1387 (1988); Toxic Substances Control Act, 15 U.S.C. §§ 2601-2671 (1986).

"hazardous substances" for purposes of CERCLA.[33] This universe is expansive indeed, and includes thousands of substances, many of which are quite common. For example, household cleaning solvents, acetic acid (vinegar), lead (a common pigment in ink), and saccharin are all "hazardous substances" under CERCLA.[34]

As a consequence, many industrial facilities, as well as residences and offices, may be locations at which some hazardous substances have come to be located, and, thus, may be considered hazardous substance "facilities." EPA, state governments, and private parties will not necessarily take remedial action with regard to all such facilities. The potential for such action with its attendant liabilities, however, exists for a significant body of real property. This perspective emphasizes the impact of CERCLA on real estate transactions.

E. *Recoverable Response Costs*

CERCLA provides for recovery of "costs of removal or remedial action" incurred by the United States or states,[35] or "necessary costs of response" incurred by "any other person."[36] Various courts have held that the term "response costs" includes costs of removal, remedial action, monitoring, testing, investigating the site, medical evaluations, relocation, provision of alternative water supplies, oversight costs, and interest.

In addition to response costs, PRPs also are liable for natural resource damages up to $50 million.[37] Under certain circumstances, however, this monetary cap does not apply,[38] and the PRP may be liable for the full amount of natural resource damages.

F. *Standard of Liability Under CERCLA*

Even before the enactment of SARA, the courts had concluded that

33. *See* CERCLA § 101(14), 42 U.S.C. § 9601(14) (1988).

34. Additionally, a material does not have to be a "waste," as it would under RCRA, to be considered a "hazardous substance" sufficient to trigger liability under CERCLA. *See* CERCLA § 107(c), 42 U.S.C. § 9607(c) (1988); United States v. Conservation Chem. Co., 619 F. Supp. 162, 222 (W.D. Mo. 1985).

35. CERCLA § 107(a)(4)(A), 42 U.S.C. § 9607(a)(4)(A) (1988).

36. CERCLA § 107(a)(4)(B), 42 U.S.C. § 9607(a)(4)(B) (1988). The statute defines "respond" or "response" as "remove, removal, remedy, and remedial action; all such terms . . . include enforcement activities related thereto." CERCLA § 101(25), 42 U.S.C. § 9601(25) (1988).

37. *See* CERCLA § 107(c)(1)(D), 42 U.S.C. § 9607(c)(1)(D) (1988); *Conservation Chem. Co.*, 619 F. Supp. at 222.

38. The $50-million limitation would not apply where: (1) "the release or threat of release . . . was the result of willful misconduct or willful negligence within the privity or knowledge of [the] person"; (2) "the primary cause of the release was a violation (within the privity or knowledge of [the] person) of applicable safety, construction, or operating standards or regulations"; or (3) the person "fails or refuses to provide all reasonable cooperation and assistance requested by a responsible public official in connection with response activities under the national contingency plan with respect to regulated carriers . . . or vessels." CERCLA § 107(c)(2), 42 U.S.C. § 9607(c)(2) (1988).

Congress intended CERCLA liability to be strict. Lack of negligence or fault, therefore, has not insulated PRPs from liability. Under applicable precedent, CERCLA plaintiffs (*e.g.*, EPA and state regulatory agencies) need not establish that a release of a particular defendant's hazardous substance caused the incurrence of response costs.[39] Rather, plaintiffs need only show that a generator defendant disposed of hazardous substances of the same kind as those found at the contaminated waste site. A plaintiff is not further required to prove that a praticular defendant's waste was present at the site and had been the subject of removal or of remedial measures, or that the defendant selected the site at which hazardous waste was dumped. The release does not have to be of the same substance or even the same kind of substance as that which the defendant disposed.[40] As a result of this strict liability construction of the statute, courts have held with some uniformity that CERCLA defendants are liable when such defendants are within one of the classes of PRPs and cannot prevail on one of the limited statutory defenses.[41]

In addition, the courts held that liability under CERCLA is joint and several where the harm is indivisible.[42] Thus, a person contributing any amount of a hazardous substance could be liable for the total amount of clean-up costs if it is not possible to apportion accurately the responsibility for the harm. Apportionment of the harm is often difficult if substances have been at a site for an extended period of time and because of the diverse characteristics of hazardous substances. Some courts have placed upon the defendant the burden of showing that there is a reasonable basis for apportionment.[43]

CERCLA liability is also retroactive.[44] Entities that disposed of hazardous substances long before the statute's enactment have been held liable for remediating disposal sites at which waste was disposed of legally and in accordance with the best disposal practices at that time.[45]

Since liability under CERCLA is strict, joint and several, and retroactive, government agencies and private parties suing under CERCLA have targeted their actions against "deep pocket" defendants. Accordingly, the financial resources of pension plans make them attractive targets for governmental and private plaintiffs.

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39. United States v. Wade, 577 F. Supp. 1326, 1331-33 (E.D. Pa. 1983).

40. *See, e.g.*, *Wade*, 577 F. Supp. at 1332-33; United States v. Bliss, 667 F. Supp. 1298, 1309-10 (E.D. Mo. 1987) (traditional tort concepts such as proximate cause do not apply).

41. *See, e.g.*, New York v. Shore Realty Corp., 759 F.2d 1032, 1044-45 (2d Cir. 1985); United States v. Price, 577 F. Supp. 1103, 1113-14 (D.N.J. 1983).

42. *See, e.g.*, United States v. Chem-Dyne Corp., 572 F. Supp. 802, 809-810 (S.D. Ohio 1983); United States v. Northeastern Pharmaceutical & Chem. Co. (NEPACCO), 579 F. Supp. 823, 844 (W.D. Mo. 1984); United States v. Mottolo, 695 F. Supp. 615, 629 (D.N.H. 1988).

43. *See, e.g.*, United States v. Ottati & Goss, Inc., 630 F. Supp. 1361, 1396 (D.N.H. 1985).

44. *See, e.g.*, *NEPACCO*, 579 F. Supp. at 839; *Mottolo*, 695 F. Supp. at 621-22.

45. *E.g.*, *NEPPACO*, 579 F. Supp. 823; *Mottolo*, 695, F. Supp. 615.

G. *Defenses to CERCLA Liability*

Parties to CERCLA lawsuits have employed a variety of defenses. Almost invariably, those efforts have failed. For example, although some courts have allowed equitable defenses to CERCLA actions, such as the unclean hands defense,[46] others have rejected such defenses as contrary to congressional intent.[47]

CERCLA explicitly provides for three statutory defenses to liability. Under section 107(b), there is no liability if:

> [the defendant] can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by —
> (a) an act of God;
> (b) an act of war;
> (c) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned . . . in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions. . . .[48]

Of these defenses, the "third-party" defense has been the most widely litigated. As its restrictive language suggests, however, the defense does not hold much promise for PRPs.

One of the most significant limitations of the third-party defense is that the defendant must have no "contractual relationship, existing directly or indirectly," with the party whose conduct allegedly was the "sole cause" of the release or threat of release. SARA defined the term "contractual relationship" as including "land contracts, deed or other instruments transferring title or possession," unless certain narrow showings can be made.[49] Thus, the owner of property may not assert the third-party defense based upon the actions of a prior landowner unless certain limited conditions are satisfied. These conditions have come to be known as the "innocent purchaser" or "innocent landowner" defense[50] of CERCLA.

Under the "innocent landowner" provisions, an owner of a site may avoid liability only if it is able to show that:

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46. *See, e.g.*, Mardan Corp. v. C.G.C. Music, Ltd., 600 F. Supp. 1049, 1057-58 (D. Ariz. 1984), *aff'd*, 804 F.2d 1454 (9th Cir. 1986).

47. *See generally* Glass, *Superfund and SARA: Are There Any Defenses Left?*, 12 HARV. ENVTL. L. REP. 385 (1988) (discussion of authority rejecting defenses to Superfund liability).

48. CERCLA § 107(b), 42 U.S.C. § 9607(b) (1988).

49. *See* CERCLA § 101(35)(A), 42 U.S.C. § 9601(35)(A) (1988).

50. It is anomalous that the "innocent landowner" provisions are referred to as a "defense," given that they are not a defense at all, but rather an exception to an exception to the third-party defense.

(1) the hazardous substance was present when the land was acquired; and

(2) the owner "did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of" on the property.[51] A purchaser has "no reason to know" about the disposal of a hazardous substance only if it undertook, before purchase of the property:

> all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability. For purposes of the preceding sentence the court shall take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.[52]

Given the restrictive nature of the innocent landowner "defense," those provisions have served to expand liability more than to narrow it. In general, the requirements of the third-party defense have proven impossible to meet.[53] Neither Congress nor the courts have defined in any practical terms the showing that would have to be made by a party to successfully assert that it had "no reason to know" of the disposal of hazardous substances.

H. *A New Type of PRP?*

As discussed above, the four categories of PRPs include current owners or operators and owners or operators at the time of disposal. Noticeably absent from this list, however, are "interim landowners." These would be landowners who first held title after any disposal took place and who transferred title to another party before any EPA proceeding was commenced. By the terms of section 107(a), such parties do not appear to be liable.

As part of SARA's "innocent landowner" provision, however, Congress included a curious provision that raises new questions about the liability of interim landowners. In section 101(35)(C), Congress provided as follows:

> Notwithstanding this paragraph, if the defendant obtained actual knowledge of the release or threatened release of a hazardous substance at such facility when the defendant owned the real property and then subsequently transferred ownership of the property to another

51. CERCLA § 101(35)(A)(i), 42 U.S.C. § 9601(35)(A)(i) (1988).

52. CERCLA § 101(35)(B), 42 U.S.C. § 9601(35)(B) (1988).

53. *See* Geiser, *Federal and State Environmental Law: A Trap for the Unwary Lender*, B.Y.U. L. REV. 643, 684 (1988); Note, *The Liability of Financial Institutions for Hazardous Waste Cleanup Costs under CERCLA*, WIS. L. REV. 139, 182 (1988).

> person without disclosing such knowledge, such defendant *shall be treated as liable under section 9607(a)(1)* of this title and no defense under section 9607(b)(3) of this title shall be available to such defendant.[54]

Although this provision appears within the "innocent landowner" provision, and would therefore only apply to parties already liable under section 107(a), the provision's mandatory language[55] arguably modifies section 107(a) by creating a new, fifth type of PRP: an interim landowner who transfers ownership without disclosing any of its knowledge regarding site releases. Whether Congress actually created such a fifth category of PRP remains an issue for the courts or Congress to clarify.

I. *The Superfund Clean-up Process*

Perhaps the worst aspect of CERCLA liability is the costly approach EPA has taken to Superfund clean-ups. As developed by EPA since CERCLA's enactment, and as modified by SARA, the Superfund clean-up process is ponderous, lengthy, and expensive. The process involves roughly ten steps:

(1) First, EPA or the state environmental agency investigates a site informally and prepares what is known as a Preliminary Assessment. The Preliminary Assessment usually involves only a review of existing records concerning a site and, perhaps, a brief site reconnaissance. The government agencies do not sample soil, groundwater, surface water, or air as part of the Preliminary Assessment. Unless access to a site is required, EPA does not normally inform any PRP that a Preliminary Assessment is being prepared.

(2) Based upon the Preliminary Assessment, EPA decides whether it will perform a further study of the site, known as a Site Investigation. The Site Investigation consists of a limited analysis of soil, surface water, groundwater and/or air samples taken from the site. As with the Preliminary Assessment, EPA does not usually inform any PRP other than the landowner that a Site Investigation is being prepared.

(3) The Site Investigation yields a report that contains data used by EPA to rank sites on a simplistic mathematical model known as the Hazard Ranking System. The Hazard Ranking System assigns numerical scores to such factors as the suspected hazardous nature of the disposed material, containment of the hazardous substances, and distance of the site to water wells and the surrounding population. This ranking system, however, is far from perfect. For example, its "affected population" figure is based upon the population within a three-mile radius in all directions from the site. By looking at the population within three miles in all directions, the model considers populations up-gradient, as well as down-

54. CERCLA § 101(35)(C), 42 U.S.C. § 9601(35)(C) (1988) (emphasis added).

55. The provision requires that certain defendants "shall be treated as liable." CERCLA § 101(35)(C), 42 U.S.C. § 9601(35)(C) (1988).

gradient, from the site, and thereby includes non-exposed populations in assessing exposure potential.[56]

(4) If the site scores above a threshold number on the Hazard Ranking System, EPA proposes that the site be added to its National Priority List (NPL). The NPL is the list of sites to receive EPA's most intense scrutiny. Currently, there are about 1,200 sites either proposed for, or actually listed on, the NPL.[57]

Despite the case-by-case determinations that are required in evaluating each site for inclusion on the NPL, the courts have held that NPL listing is an administrative process rather than an adjudication.[58] According to administrative rulemaking procedures, EPA must issue a proposed rule and offer an opportunity for comment. Such comments are in writing only, and because their review is subject to administrative rulemaking procedures rather than an administrative hearing, no opportunity is afforded for either examination of witnesses or the cross-examination of EPA's decision makers. Once the final rule is issued, a party may seek judicial review of the rule in the Federal Circuit Court in the District of Columbia.

In several instances, PRPs have challenged final NPL listings in the D.C. Circuit, but in each instance the court has upheld EPA's ruling.[59] EPA has succeeded thus far in convincing the D.C. Circuit that listing of a site on the NPL does not amount to a decision to do a clean-up, but merely qualifies the site for such work. Courts have generally been willing to overlook the fact that an NPL listing may force parties to expend millions of dollars on the subsequent steps of the CERCLA investigative process even if no remedial work ever is performed.

(5) Either before or shortly after listing a site on the NPL, EPA will identify PRPs and send them an Information Request which requires PRPs to furnish EPA with information on the PRPs' relationship to, and knowledge of, the site. EPA Information Requests are elaborate and responding to them is increasingly burdensome.

(6) Either before or shortly after listing a site on the NPL, EPA may send a Notice Letter advising the PRP of the EPA's determination that the addressee is a PRP. The Notice Letter may offer the PRP the "option" of undertaking the next step of the Superfund process. That next step is the performance of an expensive study known as a Remedial Investigation/Feasibility Study (RI/FS). The RI/FS is intended to deter-

56. A population is up-gradient if, for example, groundwater flows through the area of the affected population before it reaches the disposal site. Thus, the up-gradient population could not be exposed to any contamination from the site and should not be considered "affected" by the site.

57. 55 Fed. Reg. 35,512 (1990) (to be codified at 40 C.F.R. § 300 Appendix B).

58. *See, e.g.*, Eagle-Picher Indus., Inc. v. EPA, 822 F.2d 132, 137 & nn.6-7 (D.C. Cir. 1987).

59. *See, e.g.*, City of Stoughton v. EPA, 858 F.2d 747 (D.C. Cir. 1988) (review of three separate challenges to the NPL; while agreeing that the petitioners had "colorable" arguments, the court held for EPA).

mine the extent of site contamination and to evaluate any necessary action. An RI/FS typically takes years to complete and may cost millions of dollars.

The "opportunity" to perform the RI/FS is extended with an understanding that declining it will result in one of two responses by EPA: either EPA will perform the RI/FS and hold the PRP liable for its costs, or EPA will issue an administrative order requiring a PRP to undertake the study. As with CERCLA liability, EPA takes the view that PRPs are jointly and severally obligated to comply with administrative orders. Therefore, if EPA directs an order to ten parties, and nine are unable to comply, the tenth is obligated to do the work.

An EPA administrative order may not be ignored. The penalty for violating such an order, absent proof of sufficient cause, is $25,000 per day.[60] Moreover, if EPA performs the study itself and then sues a PRP to recover its costs, the PRP may be liable for the cost of the work, *plus*, absent proof of sufficient cause for noncompliance with the order, punitive damages of three times the cost of the RI/FS.[61]

(7) If the PRPs opt to perform the RI/FS themselves, an administrative consent order defining the scope of the RI/FS must be negotiated with EPA. Negotiation of the terms of RI/FS consent orders may take months, and EPA has shown decreasing flexibility in the terms subject to negotiation.

(8) After the RI/FS is completed, EPA must decide among the remedial alternatives outlined in the RI/FS. This decision is made through a complicated agency decision-making process that typically takes the agency months to complete. The result of the decision is reflected in a detailed Record of Decision (ROD) prepared by EPA.

(9) Once EPA has decided among the remedial alternatives, it may present the PRPs with the "opportunity" to perform the remedial work. In an increasing number of cases, EPA orders the PRPs to do the clean-up work. If there is no order and PRPs volunteer to undertake the remedial action, then they must negotiate the terms of another document, a judicially-approved consent decree. Like administrative consent orders, judicial consent decrees may be quite lengthy and complicated.

(10) Finally, either EPA or a PRP (or group of PRPs) proceeds with the clean-up. Of course, if EPA performs the clean-up, it will attempt to recover its costs from the PRP through CERCLA's liability provisions.

A simpler process applies when a private party decides to clean up a site and sue to recover the costs. Increasingly, private parties are using CERCLA offensively. Having purchased a property containing hazardous waste, a private party may clean up the property and sue the prior owner to recover its costs for that clean-up.

60. CERCLA § 106(b)(1), 42 U.S.C. § 9606(b)(1) (1988).
61. CERCLA § 107(c)(3), 42 U.S.C. § 9607(c)(3) (1988).

II. EFFECT OF CERCLA LIABILITY ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS

Even absent a statute like CERCLA, it is intuitive that the discovery of environmental contamination on a property would diminish the property's desirability and, hence, its value. Therefore, whether a public employee retirement system is purchasing real estate or simply lending money secured by such property, environmental contamination may lead to the loss of valuable principal.

CERCLA, however, makes the risks even more significant. Environmental clean-up activities are so expensive that their costs may easily exceed the value of the property. Therefore, in light of the preceding discussion regarding the broad scope of parties held liable under CERCLA, the substances considered hazardous, the costs recoverable, the standard of liability, and the exceedingly narrow group of defenses available, it is evident that contaminated property can be worse than worthless: it may give rise to liabilities disproportionate to the property's value. For this reason, administrators of employee retirement systems (or pension plans) must consider the potential for CERCLA liability and familiarize themselves with the steps necessary to protect against it.

A. *Liability of Pension Plans as Property Owners*

Like every other owner of property, a pension plan that owns property faces the risk that such ownership may result in CERCLA liability. Plan administrators must remember, however, that CERCLA does not hold liable every entity in a property's chain of title. Such entities are liable only if they: (1) owned the property at the time of disposal of hazardous substances; (2) presently own the property; or, depending on the evolving interpretation of section 101(35)(C) of CERCLA, (3) "obtained actual knowledge of the release or threatened release of a hazardous substance" at a property during their ownership and "then subsequently transferred ownership . . . without disclosing such knowledge."[62]

Thus, a plan that formerly owned property that already was contaminated when acquired, but no longer owns that property, should be able to avoid CERCLA liability as long as it either had no knowledge of any release or threatened release of hazardous substances during its ownership or, if it did have such knowledge, disclosed it to the purchaser.[63] Similarly, if a plan that currently owns property discovers contamination that pre-dates its ownership, it would appear that the plan could avoid liability by transferring the property, with appropriate disclosures, before clean-up activities are initiated. In some cases, purchasers are willing to

62. CERCLA § 101(35)(C), 42 U.S.C. § 9601(35)(C) (1988).

63. It is unclear, however, whether an entity that acquires an already-contaminated property that is continuing to leach contaminants into the groundwater would be considered an owner at the "time of disposal."

acquire such property, although obviously not for the price that the property could command if uncontaminated.

If activities during the period of the plan's ownership contributed to the contamination, or if the plan is holding the property at the time remedial action or a cost-recovery suit is initiated, CERCLA liability is a strong possibility. The third-party defense may be available in such a situation, but the plan would probably need to establish the elements of both the third-party defense and the "innocent landowner" provision. In view of the restrictive wording of these provisions, such a burden would prove difficult to satisfy.

B. *Liability of Pension Plans as Lenders*

CERCLA provides that lenders may face liability thereunder as either owners or operators of contaminated sites.[64] As discussed above, CERCLA defines the terms "owner or operator" of a facility, rather unhelpfully, as "any person owning or operating such facility."[65] A pension plan that has extended a loan secured by real property may, of course, be viewed as holding an ownership interest in the security, particularly in a state that holds to the "title theory" of mortgages. In title theory jurisdictions, granting a mortgage actually vests title in the lender.[66]

Financial institutions that lend money to companies that own or operate property contaminated with hazardous substances have long relied upon the so-called "secured-creditor" or "security-interest" exemption to shield them from liability under CERCLA. Under CERCLA, the owner or operator, among others, of contaminated property may be held strictly liable for the remediation of, and health hazards posed by, that contamination. The secured-creditor exemption excludes from the definition of "owner or operator" any "person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility."[67]

Predictably, there is little discussion in the legislative history of CERCLA regarding the meaning of "participating in the management" of a facility.[68] Some courts and commentators have argued, however, that CERCLA's legislative history evidences Congress' intent that the security-interest exemption be construed narrowly to protect lenders from liability as site owners in states that hold to the "title theory" of

64. CERCLA § 107(a), 42 U.S.C. § 9607(a) (1988).

65. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A) (1988).

66. By contrast, in "lien theory" jurisdictions, a mortgagee holds only a lien on the property.

67. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A) (1988).

68. The legislative history of the term "operator," however, makes clear that the term does not include anyone not "totally responsible" for operation. Rather, an "operator" is one who has assumed "the full range of operational responsibility" for a facility. H.R. REP. NO. 172, 96th Cong., 2d Sess., pt. 2, at 36 *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 6160, 6180.

mortgages.[69]

Court decisions establishing lender liability under CERCLA fall into two main categories: those finding liability based upon lenders that foreclose on a mortgage and take legal title to a property, and those where lenders exercise control over the property or the operations of the borrower. In addition, the courts have been debating whether a lender may hold full legal title to a property "primarily to protect his security interest" without triggering CERCLA liability. Given the importance of lender liability under CERCLA to pension plans, the leading decisions will be discussed individually below, including a recent United States Court of Appeals decision which has caused alarm in the lending community by greatly increasing the potential exposure of lenders by narrowing the scope of the secured-creditor exemption.[70]

1. Case Law

a. United States v. Mirabile

United States v. Mirabile[71] was the first case to consider the security-interest exemption. The court focused upon the degree of participation in management of the facility, rather than the foreclosure or its timing. In *Mirabile*, the owner of a paint manufacturing facility defaulted on a loan secured by a mortgage. The owner filed for bankruptcy protection under Chapter 11, but the petition was dismissed. American Bank and Trust Company (ABT) then foreclosed on the property and was the highest bidder at the foreclosure sale. Four months later, ABT assigned the property to Mirable. ABT argued that under Pennsylvania law it had obtained equitable but never legal title to the property. To recover the response costs incurred in removing drums of hazardous waste, EPA brought an action against Mirabile. Mirabile impleaded two banks, ABT and Mellon Bank (East) National Association (Mellon). The banks impleaded the United States because of activities of the Small Business Administration (SBA) at the site. The lenders argued that they were not an "owner or operator" and were not participating in management of the site, but were merely acting to protect their security interest.

ABT had secured the building against vandalism, inquired as to the costs of disposal of drums located on the property, and had a loan officer visit the property on several occasions to show it to prospective purchasers. All of these activities took place after operations had ceased. The court agreed with ABT: "Regardless of the nature of the title received by ABT, its actions with respect to the foreclosure were plainly undertaken in an effort to protect its security interest in the property."[72] The

69. *See* United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 579 (D. Md. 1986).

70. *See* United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990).

71. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1985).

72. *Id.* at 20,996.

court stated that ABT had taken "prudent and routine steps to secure the property against further depreciation."[73] The fact that ABT's involvement came after cessation of operations was significant. In a key phrase, the court found that ABT had not participated "in the day-to-day operational aspects of the site."[74] The court granted ABT's motion for summary judgment.

SBA held a second security interest in the machinery and equipment, a second lien on inventory and accounts receivable, and a second mortgage on the real property. SBA never took equitable or legal title to the property. Although SBA's loan agreement gave it authority to participate in day-to-day management, the court found no evidence that SBA had actually done so. In ruling that the SBA was not liable, the court suggested that the relevant standard of lender involvement to trigger liability under CERCLA is actual participation in daily operations, not just the power to do so. SBA had made repeated visits to the site, but the court determined that participation in purely financial aspects of the operation was insufficient to impose liability upon lenders under CERCLA.

The court, however, denied Mellon's motion for summary judgment. Mellon became involved through its predecessor in interest, Girard Bank (Girard), which had agreed to advance working capital to the plant in exchange for a security interest in inventory and assets. After the initial default on the loan, Girard became increasingly involved in facility operations. The court held that such activities as monitoring cash collateral, directing receivables to proper accounts, establishing a reporting system to the bank, and placing a bank loan officer on the borrower's advisory board were all activities expected of lenders protecting their security interest. The court held, however, that a question of fact remained as to whether Mellon's frequent visits to the site, insistence on manufacturing changes, reassignment of personnel, and day-to-day supervision were sufficient participation in management to render the bank liable under CERCLA. After ceasing operations, Girard took possession of the inventory and disposed of it through private sales and a public auction. Ultimately, Mellon settled.[75]

The *Mirabile* court focused more on the question of whether the banks' activities made them "operators" of the site than on whether the banks should be considered the "owners" of the facility. The court stressed the financial institutions' involvement in facility management, not whether and when a bank held title to real property.[76]

Moreover, the court noted that CERCLA refers to participation in

73. *Id.*

74. *Id.*

75. *See* Burcat, *Foreclosure and United States v. Maryland Bank and Trust Co.: Paying the Piper or Learning How to Dance to a New Tune?*, 17 Envtl. L. Rep. (Envtl. L. Inst.) 10,098, 10,099 n.14 (citing Andresky, *Cover Your Assets*, Forbes, Mar. 24, 1986, at 117).

76. *Mirabile* at 20,996.

management of "the facility," which it interpreted as "participation in operational, production, or waste disposal activities," and *not* in management of the business.[77] Thus, the court apparently did not view activities such as overseeing the bookkeeping and records systems as sufficient to defeat secured-creditor exemption. The court saw a distinction between a secured lender's involvement in its borrower's financial affairs and involvment in its actual operations.

b. United States v. Maryland Bank & Trust Co.

In *United States v. Maryland Bank & Trust Co.*,[78] a bank that foreclosed on property on which it held a mortgage was held liable under CERCLA for the costs of removing hazardous substances disposed of on the property prior to the bank's foreclosure. EPA commenced removal activities and brought an action against Maryland Bank & Trust Company (MB&T) to recover the costs of such activities. The timing of the bank's foreclosure was an important factor.

MB&T argued that it was not liable because of CERCLA's section 101(20)(A) secured-creditor exemption.[79] The court noted that the bank had held title for four years and thus was the owner. The court held that the exemption "covers only those persons who, at the time of the clean-up, hold indicia of ownership to protect a then-held security interest in the land . . . The security interest must exist at the time of the clean-up."[80] The court stressed that the exemption uses the present tense to refer to a party who "holds indicia of ownership to protect a then-held security interest" to explain its ruling. The court also asserted that its narrow interpretation of the exclusion was in line with Congress' intent and that a broader interpretation would unfairly benefit the mortgagee because the property would be enhanced from the clean-up without the lender being required to contribute to any of the costs.[81]

The *Maryland Bank* court construed the security-interest exemption much more narrowly than did the *Mirabile* decision. The *Maryland Bank* court distinguished *Mirabile* on the basis that the "mortgagee-

77. *Id.* at 20,997.

78. 632 F. Supp. 573 (D. Md. 1986).

79. MB&T also argued that it was not liable because it was not the "owner *and* operator." *Id.* at 578. The court, in line with other CERCLA decisions, held that it is not necessary for a party to be both owner and operator of a site for it to be liable under CERCLA.

80. *Id.* at 579.

81. *See id.* at 580. MB&T also raised the third-party defense. The court denied the government's motion for summary judgment on this question. The government argued that MB&T had an established contractual relationship with the former owners, and that MB&T had not exercised reasonable care regarding hazardous substances, or taken reasonable precautions since foreclosure. The court acknowledged that evidence concerning the contractual relationship between MB&T and the former owners was sparse. The court could not determine the reasonableness of MB&T's actions because the extent of MB&T's knowledge about hazardous wastes on the site was in dispute. *Id.* at 581-82. Therefore, the issue presented questions of fact which precluded summary judgment.

turned-owner promptly assigned the property. To the extent that [*Mirabile*] suggested a rule of broader application, the Court respectfully disagreed."[82]

c. United States v. Fleet Factors Corp.

In a case that will frighten lenders who participate in any aspect of their debtor's operations, *United States v. Fleet Factors Corp.*[83] redefined the degree of lender involvement in a debtor's operation sufficient to incur liability under CERCLA.

The lender, Fleet Factors Corporation (Fleet), had a factoring agreement with a cloth-printing facility. The agreement continued after the facility filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. The debtor-facility then converted the reorganization petition to one under Chapter 7, for liquidation. The lender foreclosed on the secured assets, which included machinery, equipment, inventory, raw materials, work in progress, and packing and shipping materials.

Fleet hired a liquidator to conduct a public auction of the equipment and inventory, and a contractor, Baldwin, to remove any remaining equipment. The liquidator allegedly moved drums of dyes and chemicals. The contractor's activity allegedly resulted in a release of asbestos from the facility.

EPA removed drums of hazardous chemicals and asbestos from the site. EPA then brought an action against Fleet and against the shareholders and directors of the debtor to recover the clean-up costs.

The court interpreted section 101(20)(A) to "permit secured creditors to provide financial assistance and general, and even isolated instances of specific, management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility either before or after the business ceased operation."[84]

With respect to Fleet's liability, the District Court denied both the federal government's and Fleet's motions for summary judgment. On appeal, the Court of Appeals for the Eleventh Circuit found that Fleet was not a present owner or operator so as to establish liability under CERCLA, because Fleet did not own, operate or otherwise control activities at the facility immediately before title to the facility was conveyed to Emanuel County due to foreclosure.[85]

The court then turned to the critical issue, *i.e.*, whether Fleet participated in management sufficiently to incur liability under CERCLA. The court rejected the distinction delineated by some district courts between permissible participation in the financial management of the facility and

82. *Id.* at 580.
83. 724 F. Supp. 955 (S.D. Ga. 1988), *aff'd*, 901 F.2d 1550 (11th Cir. 1990).
84. *Id.* at 960.
85. *Id.* at 957.

impermissible participation in the day-to-day operational management of the facility. The court held that a secured creditor may incur liability under CERCLA without being an operator if he participates in the financial management of a facility to a degree indicating a capacity to influence the business' treatment of hazardous wastes. The court held that it is not necessary for the lender to participate in the day-to-day operations of the facility in order to be liable. "Rather, a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose."[86] The court added that "the lender's capacity to influence a debtor facility's treatment of hazardous waste will be inferred from the extent of its involvement in the facility's financial management."[87]

Applying its new statutory interpretation to the facts, the court held that from 1976 until the debtor, Swainsboro Paint Works (SPW), ceased operations in February 1981, Fleet's involvement with the facility was within the parameters of the secured-creditor exemption to liability. During that period, Fleet regularly advanced funds to SPW against the assignment of SPW's accounts receivable, paid and arranged for security deposits for SPW's utilities, and, when it determined that its advanced sums exceeded the value of SPW's accounts receivable, informed SPW that it would not advance any more money.

The federal government alleged, however, that after SPW ceased operations in 1981, Fleet's involvement with SPW increased substantially. Fleet purportedly required SPW to seek its approval before shipping goods to customers, established the price for excess inventory, dictated when and to whom the finished goods should be shipped, determined when employees should be laid off, supervised the activity of the office administrator at the site, received and processed SPW's employment and tax forms, controlled access to the facility, and contracted with Baldwin to dispose of the fixtures and equipment at SPW. The court held that those activities, if proven, are sufficient to remove Fleet from the protection of the secured-creditor exemption.

Although Fleet contended that its activity was designed merely to protect its security interest and to foreclose its security interest in the equipment, inventory, and fixtures, the court held that the creditor's motives were irrelevant. The nature and extent of the creditor's involvement with the facility determine whether the exemption will apply.[88] After noting that this construction of the secured-creditor exemption is less permissive than that of previous courts, the court outlined public policy rationales for the decision, including that the ruling should motivate potential lenders to investigate thoroughly the waste management practices of potential debtors.

86. 901 F.2d at 1558.
87. *Id.* at 1559 n.13.
88. *Id.* at 1560.

d. United States v. Nicolet

In *United States v. Nicolet*,[89] EPA brought suit against Nicolet for response costs at a waste disposal site. Nicolet filed a third-party complaint against T&N plc (T&N), which had a controlling and ownership interest in the previous owner of the site and held a mortgage on the site. The United States then amended its complaint to add T&N as a direct defendant, alleging liability under various theories.

T&N moved to dismiss the United States' first amended complaint. In addition to responding to this motion, the United States moved for leave to file a second amended complaint, which sought to hold T&N liable directly as an owner or operator because it held a mortgage and actively participated in the management of the facility.

The court granted the United States' motion for leave to file a second amended complaint. In responding to T&N's motion to dismiss, the court noted that T&N's liability *vel non* "would depend on [T&N's] level of participation in the . . . facility."[90] The court cited and quoted the district court decisions in *Fleet Factors* and *Mirabile* with approval and stated that existing cases suggest "that a mortgagee can be held liable under CERCLA only if the mortgagee participated in the managerial and operational aspects of the facility in question."[91] Apparently unable to resolve this issue on a motion to dismiss, the court denied T&N's motion.

e. Guidice v. BFG Electroplating and Manufacturing Co.

In *Guidice v. BFG Electroplating and Manufacturing Co.*,[92] the defendant owner of an allegedly contaminated property impleaded the National Bank of the Commonwealth (NBC). NBC, a secured lender of the subject property, attempted to assist the current owner in resolving its financial difficulties, but ultimately foreclosed on the property. At the foreclosure sale, NBC purchased the property and took title to it. NBC held title for eight months.

The *Guidice* court absolved NBC of liability for its activities *before* foreclosure, quoting the *Fleet Factors* district court's language that the security-interest exemption has allowed secured creditors "to provide financial assistance and general, and even isolated instances of specific, management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility either before or after the business ceases operation."[93] The court held that these activities, including participation in meetings with site officials concerning the status of accounts, personnel

89. 712 F. Supp. 1193 (E.D. Pa. 1989).
90. *Id.* at 1204.
91. *Id.* at 1205.
92. 732 F. Supp. 556 (W.D. Pa. 1989).
93. *Id.* at 561 (quoting United States v. Fleet Factors Corp., 724 F. Supp. 955, 960 (S.D. Ga. 1988), *aff'd*, 901 F.2d 1550 (11th Cir. 1990)).

changes and the presence of raw materials, assistance to the borrower in obtaining an SBA loan, and even initiation of communication with the Pennsylvania Department of Environmental Resources concerning waste-water discharges, were all "insufficient to void the security-interest exemption of CERCLA. . . . The actions of the Bank prior to its purchase of the [property] at the foreclosure sale were prudent measures undertaken to protect its security interest in the property."[94]

The court justified its ruling regarding NBC's pre-foreclosure activity on the basis that it would "encourage banks to monitor a debtor's use of security property."[95] The court reasoned that a contrary ruling "would encourage a lender to terminate its association with a financially troubled debtor."[96]

With regard to NBC's actions in purchasing the property post-foreclosure, however, the court adopted the *Maryland Bank* rather than the *Mirabile* approach. The court held that the purchase of the property was not an action taken merely to protect NBC's security interest in the property.[97] To hold that purchase of such property at a foreclosure sale does not give rise to CERCLA liability "would create a special class of otherwise liable landowners."[98] Thus, "[w]hen a lender is the successful purchaser at a foreclosure sale, the lender should be liable to the same extent as any other bidder at the sale would have been."[99]

f. *In re* Bergsoe Metal Corp.

The Ninth Circuit decided in In re *Bergsoe Metal Corp.*[100] to reject the restrictive reading of the secured-creditor exemption offered by the Eleventh Circuit in *Fleet Factors*, and to replace the "capacity to influence" test proposed in *Fleet Factors* with an "actual participation" test.

Bergsoe Metals (Bergsoe) was formed in 1978 for the purpose of conducting a lead recycling operation. Sometime in 1978, representatives of Bergsoe contacted the Port of St. Helens (the Port) to discuss the construction of a lead recycling facility in St. Helens. The Port, a municipal corporation, was empowered to issue bonds to promote industrial development in the St. Helens, Oregon area. The Port agreed to issue industrial development revenue bonds and pollution control revenue bonds to

94. Guidice v. BFG Electroplating and Mfg. Co., 732 F. Supp. 556, 562 (W.D. Pa. 1989).

95. *Id.*

96. *Id.*

97. *Id.* at 563.

98. *Id.* In arriving at its decision, the court relied on Congress' addition in SARA of an exemption from liability for state and local governments acquiring "ownership or control involuntarily through bankruptcy, tax delinquency, abandonment" or similar means. CERCLA § 101(20)(D), 42 U.S.C. § 9601 (20)(D). The court, however, explained that Congress crafted no such exemption for lenders acquiring title through foreclosure.

99. Guidice v. BFG Electroplating and Mfg. Co., 732 F. Supp. 556, 563 (W.D. Pa. 1989). The court also adopted a very broad interpretation of "disposal" in finding that the lender was the owner at the time of disposal.

100. 910 F.2d 669 (9th Cir. 1990).

provide funds for the acquisition and construction of a secondary lead recycling plant and related pollution control equipment in St. Helens.

In 1979, the Port sold Bergsoe fifty acres of land on which to construct the plant. In exchange, Bergsoe gave the Port a promissory note for $400,000 and a mortgage on the property. Once the financing was completed, Bergsoe entered into a sale-leaseback arrangement with the Port wherein Bergsoe conveyed to the Port, by warranty deed, the fifty acres and the future recycling plant in exchange for tenancy under a lease.

The Bergsoe recycling plant began operating in 1982 and soon experienced financial difficulties. The plant shut down in 1986. On October 21st of that year, the United States National Bank of Oregon (Bank), which completed the financing for the facility and which held a superior right over the Port to the Bergsoe lease, put Bergsoe into involuntary bankruptcy under Chapter 11 of the Bankruptcy Code. By that time, the State Department of Environmental Quality (DEQ) had determined that various hazardous substances had contaminated the plant site.

In September 1987, the Bank and the trustee in bankruptcy filed suit against the DEQ and Bergsoe. The defendants counterclaimed against the Bank and filed a third-party complaint against the Port asserting that both the Port and the Bank should be liable for the CERCLA clean-up costs.

While the Ninth Circuit's opinion in *Bergsoe* avoided direct comment on the decision in *Fleet Factors*, it did provide that "it is clear from the statute that, whatever the precise parameters of participation, there must be *some* actual management of the facility before a secured creditor will fall outside the exemption."[101] The court found that the Port held a mere indicia of ownership solely to facilitate the financings and to secure performance by the recycler, and thus, because of a lack of actual participation in the management of that facility, failed to become an "operator" of that facility.[102]

2. Conclusions on Lender Liability Cases

The standards for determining levels of ownership and lender participation sufficient to incur lender liability under CERCLA are quickly evolving. With regard to owner liability, the court in *Maryland Bank*[103] appeared to seek a hard and fast rule that once a bank takes title to a property as a result of foreclosure, it is the "owner or operator" under CERCLA. The recent *Guidice*[104] case appears to endorse that idea, at least for properties purchased at foreclosure sales. The other decisions discussed have not involved or have ignored this question. The remaining decisions discussed above focused on the more difficult question of

101. *Id.* at 672.
102. *Id.* at 673.
103. 632 F. Supp. 573 (D. Md. 1986).
104. 732 F. Supp. 556 (W.D. Pa. 1989).

the requisite degree of a lender's involvement in a facility's management in order for that lender to incur CERCLA liability. Notwithstanding the recent decision in *Bergsoe*, the *Fleet Factors*[105] decision poses the greatest risk for lenders because fine distinctions are beginning to be drawn between levels of managerial involvement that may or may not trigger CERCLA liability. It is hoped that the Supreme Court will grant certiorari in *Fleet Factors* and resolve much of the confusion that currently exists on lender liability under CERCLA.

Lender liability under CERCLA for hazardous substance releases could alter inexorably the commercial lending industry. It could lead to an escalation in interest rates, making innovation more difficult. As noted by the *Guidice* court, it could increase bankruptcies by making lenders afraid of trying to work out problems of financially troubled borrowers.[106] Even financially healthy and responsible companies may suffer because of lenders' reluctance to make a loan in the first place. The general public will ultimately bear the higher costs that a lender incurs because of the need for such protective measures as environmental audits. Of course, to the extent that pension plans lend funds for properties that ultimately are discovered to be contaminated, the beneficiaries of such plans could be the unwilling financiers of hazardous waste cleanups.

III. Suggestions To Minimize The Potential For Environmental Liability Of A Public Employee Retirement System

As the preceding discussion illustrates, the courts have demonstrated unusual receptiveness to CERCLA actions and predictable deference to the positions of EPA and its state counterparts. Nonetheless, as one appellate court interpreting CERCLA reminded, "statutes have not only ends but also limits."[107] With this admonition in mind, the following steps are reasonable precautions against environmental liabilities that merit the consideration of public employee retirement systems investing in or lending funds secured by real property:

(1) *Require Disclosure of Knowledge by Seller, Tenant or Borrower*: As part of any land purchase or loan transaction, a plan should require that the entity (a) selling a property, or (b) seeking to use a property as security, disclose any knowledge it has concerning existing environmental conditions and any activities at the property with environmental implications. Such disclosure should be required through representations made in the transaction documents. With regard to all loan documents, lenders should be sure to structure the relative rights and responsibilities of the parties to protect their ability to engage in audits and due diligence

105. 724 F. Supp. 955 (S.D. Ga. 1988), *aff'd*, 901 F.2d 1550 (11th Cir. 1990).
106. Guidice v. BFG Electroplating, 732 F. Supp. 556 (W.D. Pa. 1989).
107. Edward Hines Lumber Co. v. Vulcan Materials Co., 861 F.2d 155 (7th Cir. 1988).

activities. Loan commitments should be subject to a satisfactory audit or inspection result, and termination or acceleration provisions should apply in the event a lender learns or suspects that a site has become contaminated. The documents should also provide that experts be allowed to inspect the site after the loan date, without notice, so that lenders may protect their security.

(2) *Require Warranties by Land Occupant*: With regard to land occupied by a borrower or tenant, warranties concerning the occupant's future activities should be considered. An occupant might be required to warrant, for example, not only that its operations will be in compliance with the law, but also that its operations will not result in any spills, leakage, disposal or other releases of any hazardous substances to, on or from the property. An occupant might also be required to warrant that its operations will not involve any substances that, if spilled or leaked, would constitute hazardous waste.

(3) *Require Indemnities from Land Sellers, Tenants or Borrowers*: Representations and warranties must, of course, be supported by indemnities for their breach. A plan must recognize, however, that such indemnities are only as worthwhile as the issuer. In certain circumstances, indemnities may be sought from the issuer's parent company or affiliate. If the plan is exposed to direct CERCLA liability, as an owner or operator, the indemnitor's ability to pay will not shield the plan from that strict liability.

(4) *Performance of an Environmental Review Before Purchase or Loan*: In view of the fact that the preceding steps may not disclose all knowledge concerning the environmental condition of a property, or that an indemnity may ultimately prove inadequate, an environmental review should be undertaken before investing in, or lending funds secured by, property that may be contaminated. Such a review is especially appropriate in light of EPA's Draft Rule.[108] Although industrial property is usually the most suspicious type of property, the potential for contamination of commercial, farm or residential property should be considered as well. The review process may be phased where appropriate, with a more simple review being used as a basis for determining whether more detailed scrutiny is warranted. An initial review should include a review of EPA's CERCLIS computer database[109] and any EPA site data, a search of state and local government pollution complaint files, ascertainment of present and past land use, and a visual site inspection for indicators of possible past or present hazardous substance handling. More complex and costly steps may include the taking of soil and water samples from the property.

108. *See* Environmental Protection Agency Draft Proposal Defining Lender Liability Issues Under the Secured Creditor Exemption of CERCLA, (BNA) No. 24, at 1162 (Oct. 10, 1990).

109. CERCLIS is the computer database of sites evaluated for possible Superfund action.

Environmental issues raise complex legal and technical questions. Lenders should consider using outside counsel and environmental specialists to assist with their environmental evaluations. The law with respect to lender liability under CERCLA is rapidly evolving; legal and technical experts can reduce a lender's exposure to significant liability by consulting with lenders as the law and environmental regulations change.

In addition, use of experts by a lender can support a finding by a judicial or administrative body that a lender made reasonable efforts to protect his security interest from environmental hazards. Perhaps these efforts would influence a regulatory agency, judge, or fact-finding body to act favorably toward a lender in such a proceeding.

Although no environmental review, no matter how detailed or costly, provides a guarantee against purchase of contaminated property, a significant degree of comfort can be achieved. The performance of a review can serve both to protect the plan's collateral and to guard against liability.

(5) *Performance of an Environmental Review Before Foreclosure or Other Participation in Facility Management*: For the same reasons that an environmental review should be performed at the initiation of a loan, such a review should also be performed before foreclosure or before the plan intervenes in facility management. Given that either assumption of title or participation in facility management may destroy the plan's secured-creditor exemption from liability, the performance of a review before taking such steps would allow an informed decision regarding the attendant risks. One conceivable result of such an analysis is a decision that the risk of liability outweighs any benefits that might be derived either from foreclosure or participation in the affairs of the borrower. Another conceivable result would be a decision to proceed with a sheriff's foreclosure sale but not to purchase the property.

(6) *Control Over the Affairs of Borrower or Tenant*: To the extent that the *Mirabile* decision may be relied upon, plans may continue to design loan documents that give plans the *power* to participate in the day-to-day affairs of their borrowers without triggering CERCLA liability. *Exercise* of such power, however, should be restricted to the most limited role possible. Whenever plans anticipate specific activities which would be more involved than general financial oversight, they should exercise caution and refer to the fifth suggestion above. In light of the *Fleet Factors* decision, the actions of a liquidator contracted by the lender may be attributed to the lender and give rise to CERCLA liability. Lenders should also keep abreast of the status of EPA's Draft Rule regarding lender liability, which will more clearly define appropriate lender liability in such situations.

(7) *Limit the Period of Ownership in the Property*: The *Mirabile* decision and a reading of EPA's Draft Rule regarding lender liability suggest that if a plan does acquire ownership of a contaminated property through foreclosure, the property should be disposed of at the earliest opportu-

nity. If possible, the plan's rights in the property should be transferred before taking legal title. Of course, the plan must not operate the facility during the period of its ownership.

(8) *Disclose Environmental Conditions When Selling or Leasing Property*: Plans should adopt policies requiring full disclosure of any of their knowledge concerning environmental conditions to borrowers or buyers. Such disclosure not only can avoid assertions of liability under CERCLA,[110] but also can help avoid claims based on fraud or deceptive practices.

CONCLUSION

While public employee retirement systems are hardly to blame for most hazardous substance contamination problems, the confluence of two factors creates a significant risk that they will be pursued as sources for funding the remediation of such problems. First, the broad language of CERCLA, as interpreted even more broadly by the courts, enables anyone who owns or, in some cases, lends money to secure real property to be the target of a CERCLA action. Second, the enormous costs of hazardous waste clean-ups create a powerful incentive for EPA, state and local governments, and private parties to recover such costs from other parties, wherever they may be found. Entities with substantial assets, such as pension plans, are the most attractive targets.

Faced with this reality, public pension funds must anticipate the potential risks of environmental liabilities and take steps to avoid or minimize them. Through the exercise of environmental due diligence in making investments and managing those investments, pension plan administrators can satisfy their dual obligations to obtain high-yield investments, including real estate, and to minimize the environmental liability risks associated with them.

110. CERCLA § 101(35)(C), 42 U.S.C. § 9601(35)(C) (1988).